MIKE KREIDLER
STATE INSURANCE COMMISSIONER

STATE OF WASHINGTON

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OFFICE OF
INSURANCE COMMISSIONER

In the Matter of	)	No. G05-44
	)	
The Financial Examination of	)	FINDINGS, CONCLUSIONS,
WESTERN UNITED LIFE ASSURANCE	)	AND ORDER ADOPTING REPORT
COMPANY	)	OF
	)	FINANCIAL EXAMINATION
A Domestic Insurer.		

BACKGROUND

An examination of the financial condition of **WESTERN UNITED LIFE ASSURANCE COMPANY** (the Company) as of December 31, 2003, was conducted by examiners of the Washington State Office of the Insurance Commissioner (OIC). The Company holds a Washington certificate of authority as a stock insurer. This examination was conducted in compliance with the laws and regulations of the state of Washington and in accordance with the procedures promulgated by the National Association of Insurance Commissioners and the OIC.

The examination report with the findings, instructions, and comments and recommendations was transmitted to the Company for its comments on June 1, 2005. The Company's response to the report is attached to this order only for the purpose of providing convenient review of the response.

The Commissioner or a designee has considered the report, the relevant portions of the examiners work papers, and submissions by the Company.

Subject to the right of the Company to demand a hearing pursuant to Chapters 48.04 and 34.05 RCW, the Commissioner adopts the following findings, conclusions, and order.

FINDINGS

Findings in Examination Report. The Commissioner adopts as findings the findings of the examiners as contained in pages 1 through 26 of the report.

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CONCLUSIONS

It is appropriate and in accordance with law to adopt the attached examination report as the final report of the financial examination of **WESTERN UNITED LIFE ASSURANCE COMPANY** and to order the Company to take the actions described in the Instructions and Comments and Recommendations sections of the report. The Commissioner acknowledges that the Company may have implemented the Instructions and Comments and Recommendations prior to the date of this order. The Instructions and Comments and Recommendations in the report are an appropriate response to the matters found in the examination.

ORDER

The examination report as filed, attached hereto as Exhibit A, and incorporated by reference, is hereby ADOPTED as the final examination report.

The Company is ordered as follows, these being the Instructions and Comments and Recommendations contained in the examination report on pages 1-10.

1. The Company is ordered to comply with WAC 284-13-280 and RCW 48.13.140 and to follow the AP&P as required by WAC 284-07-050(2) by obtaining valid, reliable and current appraisals for all properties at the time of acquiring or making investments involving real property. Instruction 1, Examination Report, page 2.

2. The Company is ordered to comply with RCW 48.05.073 and to recognize gains only when transactions qualify for such recognition by meeting all the requirements of SSAP No. 40, including the down payment restrictions. Instruction 2, Examination Report, page 2.

3. The Company is ordered to comply with RCW 48.05.250, RCW 48.05.073, WAC 284-07-050 and WAC 284-07-130 and to ensure that the alternative cash flow receivables are accurate, admissible and collectible at the amounts presented in the financial statements. Instruction 3, Examination Report, page 3.

4. The Company is ordered to comply with RCW 48.05.250 and file a true statement of its financial conditions, transactions and affairs; with RCW 48.05.073 which requires the filing of its financial statements in accordance with AP&P; and WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and AP&P. This would include valuation of its joint ventures. Instruction 4, Examination Report, page 3.

5. The Company is ordered to comply with RCW 48.05.250 and file a true statement of its financial conditions, transactions and affairs; with RCW 48.05.073 which requires the filing of its financial statements in accordance with AP&P; and WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and AP&P, by recording the $11,200,000 intercompany tax issue as a capital contribution. Instruction 5, Examination Report, page 4.

6. The Company is ordered to comply with RCW 48.13.273(2)(e) and not invest in lower grade obligations beyond the levels permitted by the Company or, conversely, to seek approval from the Commissioner in order to hold obligations exceeding those limitations. Instruction 6, Examination Report, page 4.

7. The Company is ordered to conduct its administrative and investment processes pursuant to RCW 48.05.073, RCW 48.05.280, RCW 48.31B.025(1)(c) and RCW 48.31B.030(1)(a)(i). Instruction 7, Examination Report, Page 5.

8. The Company is ordered to comply with RCW 48.05.073 which requires the filing of its financial statements in accordance with the AP&P; with RCW 48.05.250 which requires filing of a true statement of its financial conditions, transactions and affairs; with RCW 48.05.280 which requires every insurer to keep full and adequate accounts and records of its assets, obligations, transactions, and affairs and with WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the AP&P. Instruction 8, Examination Report, page 6.

9. The Company is ordered to comply with RCW 48.05.370 and institute sound and sensible control procedures in all areas where internal controls are missing or inadequate. The Company is further ordered to institute appropriate "best practices" procedures to prevent, detect and report suspected instances of fraud. Instruction 9, Examination Report, page 7.

10. The Company is ordered to comply with RCW 48.05.280 and keep full and adequate records of its assets, obligations, transactions and affairs and to design and implement adequate procedures which assure that assets are properly recorded and valued. Instruction 10, Examination Report, page 8.

11. The Company is ordered to consider updating its Business Contingency Plan after the operational environment has stabilized and job functions and duties have been redefined. The revised plan needs to reflect changes in staff assignments and responsibilities and to conform to new job processes and functions. Comments and Recommendations 1, Examination Report, page 8.

12. The Company is ordered to consider properly segregating duties to ensure that initiation of trades, trade settlement, posting of transactions to the general ledger, and accounting for investments are all coordinated, but independent, functions. Comments and Recommendations 2, Examination Report, page 8.

13. The Company is ordered to consider setting up a centralized records retention and administration unit to assure universal and consistent adherence to federal and state statutory requirements. This should be more efficient and effective than relying on each business unit to monitor and comply with this important function. Comments and Recommendations 3, Examination Report, page 9.

14. The Company is ordered to consider periodically evaluating the financial condition of outside agents or others who handle premiums. Comments and Recommendations 4, Examination Report, page 9.

15. The Company is ordered to consider analyzing and implementing all suitable recommendations in the February 2003 IT Audit and justifying the reason for not complying with any deemed unsuitable. Comments and Recommendations 5, Examination Report, page 9.

16. The Company is ordered to consider analyzing and implementing all suitable recommendations in the March 2004 Security Audit and justifying the reason for not complying with any deemed unsuitable. Comments and Recommendations 6, Examination Report, page 9.

17. The Company is ordered to consider seeking more income generation methods for foreclosed properties awaiting sale. Comments and Recommendations 7, Examination Report, page 10.

18. The Company is ordered to consider instituting a formal written program to obtain and record management approval for all official financial reporting packages, ensuring that such documents represent a true statement of WULA's financial condition. Comments and Recommendations 8, Examination Report, page 10.

19. The Company is ordered to consider setting a timetable to reassess its reinsurance needs in light of its exposure tolerance and determining the most effective and economical way of balancing profit against the need for protection. At that time, any resulting reinsurance requirements should be contracted with third party reinsurers, either directly or through an intermediary. Comments and Recommendations 9, Examination Report, page 10.

IT IS FURTHER ORDERED THAT, the Company file with the Chief Examiner, within 90 days of the date of this order, a detailed report specifying how the Company has addressed each of the requirements of this order.

ENTERED at Tumwater, Washington, this 30th day of June, 2005.

MIKE KREIDLER
Insurance Commissioner

The following are the Company's comments on the Draft Examination report forwarded under cover of letter dated June 1, 2005, relative to those items that result in financial statement adjustment:

Instruction 1—The Company is in general agreement with the asset write-downs, having recorded the majority of the OIC's findings and others in its 2003 audited statutory financial statements.

The OIC exam does reflect a $7 million charge for appraisal of "Dillingham" interests. The company merely points this out, as it has not been reflected in any previous WULA financial statement to this point. So this is new. Furthermore, the Company's external auditors will insist that it be recorded it in either 2003 or 2004, not in 2005 as the OIC exam report suggests.

Instruction 2—The Company agrees in theory with the gross adjustments for the deferred gain items noted. However, it disagrees with how the resultant effects on the AVR have been arrived at. The examiner's entry related to this instruction, AJE 3, debits surplus and credits the AVR, as if the de-recognition of gain merely shifts amounts between the two. Instead, it should be a debit to surplus, with a credit to asset carrying values. And then, the AVR must <u>decrease</u> for the effects of lower asset carrying value and reduced realized capital gain, not increase as the examiners propose. The decrease in the AVR would be offset by a corresponding increase to capital and surplus.

The Company has contacted the exam unit and believes the draft report will be modified to reflect a correction of this item.

Instruction 3—The Company agrees in principle with the alternative cash flow adjustment. However, it recorded the loss in 2004 rather than in 2003 and it was a lesser amount based on subsequent recoveries of some of the amounts. This is for the Department's information only, and the Company does not request adjustment in the examination report. The Company has no disagreement with the stock charge off.

Instruction 4—The Company concurs with the OIC finding, and it was booked in the 2003 Amper audit already.

Instruction 5—The Company concurs with the OIC finding, and it was booked in the 2003 Amper audit already.

Instruction 6—The Company concurs with the OIC finding, and it was booked in the 2003 Amper audit already.

Following are other comments relating to the remainder of the Draft Examination report relating to items that did not result in financial statement adjustment:

Page 4, Instruction 7--Subpoint 1) indicates that MMS booked transactions into WULA's ledger without timely notification to WULA, resulting in erroneous quarterly reporting to OIC. The Company is unaware of the specific examples. The way the comment is worded, it might cause the reader to wonder how erroneous quarterly reporting occurred if the transactions were actually booked in the ledger. After all, the Company uses the ledger as its basis for preparation of its quarterly and annual reporting to the OIC Perhaps the comment refers to the timing of the recording, such as failing to record in time to be recognized in the proper quarter, or backdating corrections and so forth. The Company thinks the OIC should re-word their comments here to be more understandable as to the exact nature of the problem.

Page 8—Centralized record retention—it is unclear how the Company does not comply.

Page 10, item 9--the comments on the reinsurance risk retention seem inappropriate to the Company. On the risk retention, this is addressed in the Company's life block through reinsurance treaties that limit the Company's exposure to $100,000 per policy. A later section of the report indicates that the Company does an acceptable job of monitoring its reinsurance treaties. On the annuity block, the Company is not sure that it is appropriate to comment on risk retention.

Page 11, Territory and Plan of Operation--The OIC should update the report to state that the Company's underwriting, policy preparation, claims settlement, etc are now performed at the Spokane Valley, WA location, not in Post Falls. Also, the report should note that the Alaska suspension was continued beyond the initial one-year period to extend until the time the Company is released from rehabilitation.

Page 13, Metropolitan Mortgage & Securities--the report erroneously states that Metropolitan is the parent of Summit Securities, Inc. This comment should be stricken.

Page 13, Old Standard--it may be inappropriate to state that the reinsurance treaty with OSL was "suspended". It was inactivated with respect to new premiums in accordance with provisions of the treaty. Other terms under the treaty, such as obligation to reimburse Western for claims paid, were not "suspended".

Page 14, Summit Securities—There is no entity within the group known as Old Standard Lending. That may have been a DBA used by OSL itself to refer to its lending origination business, but it was not a separate corporation owned by Summit.

Page 15, Board and officers—There should be some statement to the effect that the Board was dissolved upon entry of the Rehabilitation Order and that officers were essentially supplanted by the Recevier.

Page 16. Pension plan--The contributory limit is not 6%. It is a maximum dollar amount prescribed by the IRS, and it is subject to annual change.

Page 16. Deferred comp plan--the Metro deferred comp plan is a <u>non</u>-qualified plan, not a qualified plan.

Page 18. Reinsurance--same comment above regarding use of the term "suspended".

Page 20. Subsequent events--item 3) should also mention that the bulk of the Post Falls operation was relocated to the Spokane Valley, WA facility.

AS SUPPLEMENTED BY BILL ZEHNER, COMPANY ACTUARY:

In response to the comments you sent to me regarding our 2003 statutory statement reserves, I have the following comments:

1. The report states that the Actuarial Opinion and Memorandum (AOM) for December 31. 2003 was found to be unreliable because of the asset and investment assumptions used in cash flow testing for the reserve adequacy analysis.
   The asset default assumptions used in testing were based on the company experience through the first half of 2003. As this experience was immature, assumptions were established conservatively. The experience was consistent with the asset values reflected in the September 2003 balance sheet on which the analysis was based. The asset expenses used in testing were based on the latest available charges from Metropolitan. Thus, the asset assumptions were derived from the current company experience available at the time the testing was performed. This is consistent with Actuarial Standard of Practice No. 22 Section 3.3.3.a that allows the actuary to select assumptions that adapt company experience.
   The investment strategy used in testing was the company's current investment strategy. This is consistent with Actuarial Standard of Practice No. 7 Section 3.4 that requires the actuary to consider the insurer's investment strategy.
2. It was noted in the report that cash flow testing included assets whose values were seriously misstated as a result of faulty or missing appraisals. The asset values used in the asset adequacy analysis were those shown in the September 2003 Quarterly statement as revised on January 29, 2004. These values were provided by David Luhn and Dale Whitney and were relied upon as stated in the AOM. This is consistent with Actuarial Standard of Practice No. 7 Section 4.3 that permits the actuary to rely upon data supplied by others.
3. A decision was made to use the 2004 AOM to infer the adequacy of the reserves for 2003. The 2004 AOM justified a reserve adjustment in the amount of $12.5 million. However, in the IOC actuary's opinion, no reserve adjustments are necessary for 2003. How is this opinion consistent with the reserve adjustment that resulted from the 2004 AOM?
4. The 2004 AOM assumed that all ceded reinsurance is valid and collectable. This was based on the payment of amounts due under the reinsurance treaties through mid-December and the intention of the reinsurer to continue pay amounts due under the treaty. At the time the 2004 AOM was prepared, amounts due under the treaty were being paid several months after they were due: but they were being paid. Actuarial Standard of Practice No. 22 Section 3.8 states that the actuary should consider whether reinsurance receivables will be

collected when due, and any terms, conditions, or other aspects that may be reasonably expected to have a material impact on the cash flow analysis. We do not believe that the tardy payment of the reinsurance receivables has a material impact on the cash flow analysis. Consequently, we believe the reserve credits to be collectable and the reinsurance arrangements to be valid. Furthermore, the company has not enforced its rights to arbitration under the treaty provisions to collect these receivables. Until the company has exhausted all efforts to collect amounts due under the treaty, it is not possible to determine that the reserve credits are not collectable.